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NebFact



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Setting Up Your Own Business: **The Limited Liability Company**

by Paul H. Gessaman, Extension Economist

This is one in a series of **NebFacts** providing information on the principal forms of business organization used by small businesses. A broad overview of the advantages, limitations, and tax implications of each form of business organization is included. Titles in the series are listed at the end of each NebFact.

Your need for legal and tax advice: While the information contained in this document is thought to be accurate, it should not be used as a substitute for legal advice on matters related to business organization, taxation, estate planning, or other business and financial management matters. Consult with your legal and tax advisers before making decisions.

Form of Business Organization:

The limited liability company (LLC) is a legal entity separate and distinct from the personal affairs and other business involvements of its owners (called "members"). A LLC has some characteristics similar to those of a limited partnership, some corporation-like characteristics, and still other characteristics unique to the LLC form of business organization.

In some states, limited liability companies have been authorized for several decades. Nebraska's LLC authorization was first enacted in 1993 and amended in 1994 to authorize formation of family farm limited liability companies. Further changes in the authorizing statutes were enacted in 1997 in LB 44 and LB 361. With the LB 361 modifications, the formation of a LLC has been simplified, LLC taxation has been made consistent with the IRS regulations released in late 1996, and the legal standing of a LLC in Nebraska was made comparable to that of LLCs in other states. Under LB 44, the Secretary of State upon request is authorized to reserve and protect a business name for a limited liability company.

One or more persons may organize a LLC by preparing and filing duplicate copies of articles of organization with the Nebraska Secretary of State. The articles must provide a comprehensive description of the LLC's name, the purpose for which it is organized, its principal place of business and

registered agent, the cash and property to be invested in it, rights and requirements for admitting additional members, and the identity and addresses of managers. The articles also may identify (a) the LLC's life span unless a shorter period is specified, the life span is perpetual; and (b) any other provisions not inconsistent with the statutes and desired by the members. Upon issuance of a certificate of organization by the Secretary of State, the LLC can commence business activities unless a delayed effective date is specified in the articles of organization.

A LLC may be dissolved when: (a) a life span specified in the articles of organization expires, (b) the members unanimously agree in writing that it should be dissolved, (c) any other dissolution cause specified in the articles of organization becomes a reality, or (d) a court rules that the LLC should be dissolved. Operating procedures for the LLC are set forth in its articles of organization, or in its regulations (similar to the bylaws of a corporation), or in its operating agreement (similar to a partnership agreement). LLC management can be vested in a member or members, or in a manager or managing entity with no ownership interest. With the exception of liabilities for unpaid taxes, members and managers of a LLC are not liable for LLC debt, liabilities, or other obligation including a judgment or decree. Thus, they are protected from general liability though their investments in the LLC, if any, are at risk. This limitation of liability can be nullified if members give personal guarantees for the LLC.

An ownership interest in a LLC is part of a member's personal estate and can be transferred or assigned according to procedures specified in the articles of organization or in the operating agreement. If neither the articles of organization nor the operating agreement specifies the procedures for an ownership interest transfer, a transfer to a non-member of the LLC must be approved in writing by members other than the transferor who hold a majority in interest. If written consent by a majority in interest is not forthcoming, but a transfer of ownership interest occurs, the ownership interest can be held by a person who is not a member. When this happens, the recipient of the ownership interest has no right to participate in management, but does have the right to share in profits or other compensation and in the return of capital.

As a separate legal entity, LLC finances and records are established and maintained independently of the members' personal financial arrangements and other business involvements. As is typical of similar legal entities, this separation of finances and records makes it easier to prepare reliable financial analyses of the business unit.

If you are considering organizing a LLC that will own and operate part or all of your business activities, you should secure both legal and tax advice specific to your circumstances, the outcomes you want to attain, and the actions you are considering. Do not make decisions without receiving skilled professional advice.

Potential Advantages of a LLC:

The LLC provides its owners (the members) with a very flexible and adaptable form of business organization that provides liability protection comparable to the protection provided by incorporation of a business unit. Unless personal guarantees have been given, a member's liability is limited to the amount invested in the LLC, though as indicated above, the manager(s) and/or member(s) have full liability for unpaid taxes.

A LLC can be established at moderate cost in a relatively short time. Management by all members, by one or more members, or by a non-member individual or business entity is allowed. (The management arrangements are specified in the articles of organization.) Ownership interests can be transferred using procedures described in the articles of organization or operating agreement, or by consent of a majority

in interest. Thus, the members have a high level of flexibility in setting up or modifying business arrangements.

Possible Limitations of a LLC:

While some other states have extensive experience with LLCs, the track record of LLCs in Nebraska is limited. At this time, it appears that limited experience of individuals and professional advisers with the realities of organizing, operating, transferring, dissolving, and defending LLCs may be the most important single concern about this form of business organization. Some lenders have had limited experience with lending to LLCs, and may be reluctant lending commitments. It may be more difficult to correctly anticipate ownership and management issues that arise during LLC operations, and to develop useful outcomes to those issues. However, experience is accumulating rapidly, and Nebraska's authorizing statutes now are very similar to those in other states with considerably more experience. Thus, it appears that if the LLC form of business organization is suitable for the business activity under consideration, it can be used with confidence by interested persons.

As is the situation with all multi-owner entities, the suitability and viability of a LLC almost certainly will be closely linked to the ability of members to work together without conflict to attain desired outcomes.

Tax Implications – general:

All real and personal property held by a LLC is taxable to the extent set by Nebraska law. Cash wages paid to LLC employees are subject to payroll taxes in the same manner as for employees of any other type of business entity.

Under the simplified regulations released in late 1996, the federal income tax filing status of a LLC is determined by an election made when the income tax return is filed. Unless the LLC elects to be taxed as a corporation, a single-member LLC is taxed as a sole proprietorship and a multiple-member LLC is taxed as a partnership. A LLC owned by a corporation will be taxed as a corporate division. State income tax filing status is the same as federal income tax filing status. When the LLC is taxed as a sole proprietorship or as a partnership, and assets are placed in or withdrawn from the LLC the tax consequences are those typical of the same transactions by a sole proprietorship or a partnership. This characteristic makes placing land and other appreciating assets in a LLC with sole proprietorship or partnership tax status presently appears to be much more feasible than placing such assets in a corporation.

Net operating income or loss and capital gains and losses pass through to members and nonmember owners for taxation purposes. As such these financial flows are subject to state and federal income tax and, where applicable, to self-employment tax.

Distributions of LLC income can be proportional to ownership interests, or in compliance with an alternative pattern established in the articles of organization _ one that's tailored to the needs and interests of family members. However, if you want to use an alternative pattern of income distributions, be sure to secure tax advice prior to implementing non-proportional distributions. You need to understand all the potential tax consequences before making non-proportional income distributions.

Gift Tax and Estate Tax Implications:

For members of a LLC, all aspects of the gift tax, estate tax, and inheritance tax are the same as those

applicable to any individual. Gifting of tangible assets outside the LLC as a means of utilizing the nontaxable gift allowance of up to \$10,000 per recipient per year (up to \$20,000 for a joint gift by husband and wife) can be very difficult as assets with the correct value may be not readily available. Gifting may be feasible only if the prospective donor has financial ability to make such gifts without reducing involvement in the LLC and without disrupting non-LLC business and personal life activities.

Gifting fractional ownership interests in annual amounts less than the tax-free limits can be advantageous when such transfers are authorized in the articles of organization or when written approval is provided by members with a majority in interest. The gift of an ownership interest is noted in the LLCs ownership account to complete the gift. If desired, it is possible over time to transfer part or all of the ownership interest from the older generation to members of the younger generation while retaining management control.

Estate planning can provide a plan for minimizing the legal and tax costs of orderly transfer of business and personal assets to successors. If you are considering gifting or other LLC ownership interest transfers to certain to secure and follow the recommendations of your legal and tax advisers when planning and implementing the gift or transfer.

Cooperative Extension publications in this series:

- [NF 96-253 *Setting Up Your Own Business: The Sole Proprietorship*](#)
- [NF 96-254 *Setting Up Your Own Business: The Partnership*](#)
- [NF 96-255 *Setting Up Your Own Business: The "S" Corporation*](#)
- [NF 96-256 *Setting Up Your Own Business: The "C" Corporation*](#)
- NF 96-257 *Setting Up Your Own Business: The Limited Liability Company*

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